

Message Text

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C O N F I D E N T I A L SECTION 1 OF 3 NAIROBI 7836

EXDIS

E. O. 11652: GDS
TAGS: ECON, EFIN, EAID, SU
SUBJECT: SUDAN-U.S. BILATERAL FINANCIAL DISCUSSIONS

REF: KHARTOUM 2280

FOLLOWING IS MEMORANDUM OF CONVERSATION PREPARED BY EMBASSY
KHARTOUM AS REVISED AND CLEARED BY HARROP, HORMATS AND
BERGUS IN NAIROBI:

1. SUMMARY: DEPUTY ASSISTANT SECRETARIES HARROP AND HORMATS
MET WITH MINFIN ABDUL-SALAM MAY 20 TO DISCUSS ECONOMIC
PROBLEMS. LATTER DESCRIBED SUDAN'S SIGNIFICANT ECONOMIC
DEVELOPMENTS INCLUDING FOUR PERCENT PLUS REAL GROWTH RATE
IN LAST FIVE YEARS AND NECESSITY OF SUDAN RECEIVING BALANCE OF
PAYMENTS SUPPORT TO ACHIEVE ITS DEVELOPMENT OBJECTIVES AND CARRY
OUT POSITIVE REGIONAL ROLE. HE ACKNOWLEDGED STRUCTURAL
PROBLEMS IN PAYMENTS DIRECTLY RELATED TO ACCELERATED
DEVELOPMENT STRATEGY. GOS HAS ADOPTED ECONOMIC RATION-
ALIZATION POLICIES WHICH ARE POLITICALLY UNPALATABLE BUT
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CLOSELY CONFORM WITH RECOMMENDATIONS OF IMF. HOWEVER,
IMF INSISTENCE ON EXCHANGE RATE ADJUSTMENTS HAS BECOME AN
OBSTACLE TO RATIONALIZATION GOALS. U.S. SIDE STRESSED
THAT ADOPTION OF IMF REFORMS WOULD PROVIDE BASIS FOR SOLID
LONG TERM GROWTH. ADOPTION OF SUCH A PROGRAM WOULD STRENGTHEN
U.S. ABILITY TO HELP, BUT USG RESOURCES
AVAILABLE ARE LIMITED AND WOULD NOT BE LARGE COMPARED WITH

ARAB DONORS. MINFIN DESCRIBED IN CONSIDERABLE DETAIL PROBLEMS IN NEGOTIATIONS WITH IMF. IMF HAS ADOPTED ALL OR NOTHING POSTURE AND LINKED TRUST FUND FACILITY (30-40 MILLION DOLLARS) WITH STANDBY. IT NOW APPEARS LIKELY THAT SUDANESE WILL NOT BE ABLE TO BENEFIT FROM TRUST FUND DESPITE THEIR ADOPTION OF WHAT THEY FEEL IS REFORM PACKAGE. END SUMMARY.

2. DEPUTY ASSISTANT SECRETARIES HARROP AND HORMATS, ACCOMPANIED BY AMBASSADOR AND ECONCHIEF, MET WITH MINISTER FINANCE OSMAN HASHIM ABUDL-SALAM AND MINISTER OF STATE FOR FINANCE FAROUK MAQBUL FOR SLIGHTLY MORE THAN 90 MINUTES ON MAY 20. THIS MEETING WAS ONE OF A SERIES OF BILATERAL MEETINGS, PRIMARILY ON FINANCIAL AFFAIRS, CONDUCTED WITH PRESIDENT NIMEIRI, VICE PRESIDENT AND FOREIGN MINISTER BAKR AND MINISTER OF PLANNING MUSTAFA (SEE SEPTELS). MINFIN OPENED WITH 25-MINUTE DESCRIPTION OF ACCOMPLISHMENTS AND PROBLEMS OF SUDAN'S ECONOMY. THEREAFTER, SUDAN'S CURRENT NEGOTIATIONS WITH IMF WERE DISCUSSED IN DETAIL.

3. ON SUDAN'S ECONOMIC REQUIREMENTS, HE SAID, GOS PRESENTLY CONCERNED ABOUT FINDING THE NECESSARY INTERNATIONAL SUPPORT REQUIRED TO MEET THEIR DEVELOPMENT OBJECTIVES, PARTICULARLY BALANCE OF PAYMENTS SUPPORT. SUDAN HAS ADOPTED AN AMBITIOUS DYNAMIC DEVELOPMENT PROGRAM. IT IS WELL THOUGHT OUT TO MEET SUDAN'S AND REGIONAL REQUIREMENTS AND DEPENDS ON ACTIVE PARTICIPATION OF NEIGHBORING ARAB STATES. GOS HAS JUST
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COMPLETED A FIVE-YEAR DEVELOPMENT PLAN DURING WHICH A "VERY GOOD" REAL ANNUAL GROWTH RATE OF SLIGHTLY MORE THAN FOUR PERCENT WAS ACHIEVED. TARGET UNDER THE NEW SIX-YEAR PLAN IS A REAL GROWTH RATE OF 7.5 PERCENT.

4. MINFIN THEN DISCUSSED SUDAN'S "SHORT-TERM" PAYMENTS PROBLEM AND CURRENT STRUCTURAL GAP. TRADITIONAL EXPORTS ARE GROWING SATISFACTORILY, BUT NEW INDUSTRIES ARE NOT YET EXPORTING. NEWLY COMPLETED PROJECTS ARE NOT YET PRODUCING AT OPTIMUM LEVELS. FURTHER, BECAUSE DONORS PROVIDE FOREIGN EXCHANGE FOR NEW DEVELOPMENT PROJECTS RATHER THAN FOR IMPROVEMENTS OF EXISTING PROJECTS, EMPHASIS HAS TOO FREQUENTLY BEEN PLACED ON FORMER, AND EXISTING PROJECTS HAVE BEEN SLIGHTLY NEGLECTED. ALSO, ELEMENTS OF THE TRANSPORTATION AND POWER STRUCTURE WERE NEGLECTED AS SUDAN ENCOUNTERED INCREASED ENERGY PRICES AND CONSUMPTION, THE LATTER PRIMARILY DUE TO DEVELOPMENT REQUIREMENTS.

5. GENERATION OF REAL LOCAL RESOURCES IS LAGGING. OLD AND NEW PROJECTS ARE NOT YET FULLY PRODUCTIVE WHILE UNANTICIPATED DEVELOPMENT REQUIREMENTS HAVE DIVERTED

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RESOURCES. CURRENTLY, TAXATION IS 28 PERCENT OF GDP.
CONSEQUENTLY, ADDITIONAL TAXATION CANNOT REALISTICALLY
BE USED TO GENERATE ADDITIONAL LOCAL REAL RESOURCES. BASIC
PROBLEM IS IN PUBLIC SECTOR WHERE STATE CORPORATIONS ARE
NOT DELIVERING SAVINGS BUT DEFICITS.

6. SUDAN HAS NOT ADOPTED NEW ECONOMIC RATIONALIZATION
POLICIES. IMPORTS HAVE BEEN STRICTLY LIMITED TO MEET
REQUIREMENTS FOR DEVELOPMENT AND STRATEGIC COMMODITIES.
WITH NIL VALUE IMPORT SYSTEM, CONSUMER GOODS IMPORTS MAKE
ONLY A VERY SMALL CLAIM ON GOVERNMENT FOREIGN EXCHANGE
RESOURCES. GOS HAS RECOGNIZED THAT EXISTING ENTERPRISES
MUST NOT BE STARVED IN ORDER TO MEET LONG-TERM DEVELOPMENT
OBJECTIVES. BALANCE MUST BE FOUND BETWEEN SATISFACTION OF
PEOPLE'S CURRENT AND FUTURE ASPIRATIONS. SUDAN'S PEOPLE
NEED TO SEE AND FEEL THAT THEIR LIVES ARE IMPROVING.

7. SUDAN IS APPROACHING ITS CURRENT ECONOMIC PROBLEMS IN
A FRAMEWORK OF INTERNATIONAL COOPERATION. WITH THE ADVICE
OF THE IMF THEY ARE STUDYING AND MODIFYING PRODUCTION
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RELATIONS OF PUBLIC SECTOR CORPORATIONS. IMF IS ALSO ASSISTING THEM IN TAKING CRITICAL LOOK AT FISCAL IMPLICATIONS OF DEVELOPMENT AIMS. THEY CONSIDER IMF VIEWS AND ADVICE TO BE VALUABLE AND THEY CONSIDER THEMSELVES TO HAVE HAD EXTENSIVE EXPERIENCE WITH IMF SYSTEM. MINFIN EXPRESSED HIS CONCERN THAT IMF SHOULD NOT BECOME AN OBSTACLE TO SUDAN'S ACHIEVING ITS ECONOMIC RATIONALIZATION GOALS. SUDAN HAS MOVED VIGOROUSLY IN THE DIRECTION OF IMF SUGGESTIONS, PARTICULARLY IN TERMS OF EXPORT PRODUCTION RELATIONS AND ADDED FISCAL CONTROLS. IN SUDAN'S VIEW, IMF SHOULD BE PROVIDING MAXIMUM SUPPORT TO SUDAN'S BOP REQUIREMENTS DESPITE CONTINUING DIFFERENCES ON EXCHANGE RATE ISSUES.

8. MINFIN HIGHLIGHTED PROBLEM OF PROJECT FINANCING. GOS HAD BEEN INCLINED TO ACCEPT PROJECTS WHERE FOREIGN DONORS OR INVESTORS PROVIDED 75-80 PERCENT OF RESOURCES REQUIRED AND IT WAS ASSUMED THAT BANK OF SUDAN(BOS) COULD MEET RESIDUAL REQUIREMENTS. THIS WAS AN ERRONEOUS ASSUMPTION WHEN BOS ALREADY WAS IN DEFICIT POSITION. THEREFORE, GOS IS SEEKING BOP SUPPORT, TRYING TO REDUCE EXTERNAL OBLIGATIONS, AND SEEKING TO RESTRUCTURE ITS DEBT TO OBTAIN FURTHER SOFTENING OF TERMS. IN THEIR BROAD DEVELOPMENT AIMS, THEY FEEL THAT THEY HAVE THE SUPPORT OF THE ARAB FUNDS AND GOVERNMENTS AND SEE NO LESSENING OF PREVIOUS COMMITMENTS.

9. DAS HARROP THANKED MINFIN FOR HIS FINE PRESENTATION AND SAID HE WAS IMPRESSED BY SUDAN'S ECONOMIC ACHIEVEMENTS. HE ASKED FOR CLARIFICATION OF MINFIN POINTS ON PROJECT FINANCING AND THE BUILD-UP OF EXTERNAL DEBT. U.S. PROGRAMS FOR BOP ASSISTANCE WERE LIMITED. THE MOST PROMISING SUCH PROGRAM WAS PL-480 AND USG IS LOOKING FOR WAYS MORE EFFECTIVELY TO USE PL-480 IN SUDAN. WE INTEND TO BE AS HELPFUL AS POSSIBLE TO SUDAN. IF SUDAN REACHED AGREEMENT
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WITH IMF, THEIR ARGUMENTS FOR FINANCIAL SUPPORT FROM THE U.S. AND OTHER GOVERNMENTS WOULD BE MORE PERSUASIVE. ALSO, HORMATS ASKED ABOUT SUDAN'S POSITION ON IMF TRUST FUND. IT APPEARED THAT SUDAN WAS ABOUT TO LOSE ACCESS TO 30-40 MILLION DOLLARS. HORMATS STRESSED THAT ALTHOUGH IMF REFORMS MIGHT BE DIFFICULT, SUCH SHORT-TERM MEASURES WOULD PROVIDE SOLID BASIS FOR LONG TERM GROWTH. ADOPTION OF SUCH A PROGRAM WOULD STRENGTHEN USG ABILITY TO SUPPORT SUDAN ALTHOUGH "U.S. AMOUNTS WOULD PROBABLY NOT BE LARGE COMPARED TO AMOUNTS AVAILABLE FROM ACROSS THE SEA."

10. MINFIN REPLIED INDIRECTLY TO HORMATS' QUESTIONS BY FURTHER EXPLANATION OF SUDAN'S FOREIGN EXCHANGE DIFFICULTIES AND A MORE DETAILED EXPOSITION OF CURRENT NEGOTIATIONS WITH IMF. HE OUTLINED HOW SUDAN'S DEVELOPMENT EFFORTS HAD

STARTED FROM A POSITION OF FOREIGN EXCHANGE SCARCITY AND HOW PARTIAL FOREIGN FINANCING OF PROJECTS HAD ADDED TO SUDAN'S BOP PROBLEMS. IN THIS REGARD, SUDAN IS TAKING CORRECTIVE MEASURES AND MUST STRUCTURE PROGRAMS FOR FULL EXTERNAL PROJECT FINANCING. HOWEVER, BEFORE THIS PROBLEM WAS FULLY RECOGNIZED, SERIOUS FOREIGN EXCHANGE PROBLEMS HAD DEVELOPED IN OTHER PARTS OF THE ECONOMY. FOR EXAMPLE, LACK OF FOREIGN EXCHANGE FOR SPRE PARTS HAD REDUCED CAPACITY OF TRANSPORTATION INFRASTRUCTURE AND HANDICAPPED LOCAL INDUSTRY. THIS DROP IN UTILIZATION, IN TURN, LEAD TO GREATER FOREIGN EXCHANGE SHORTAGES. VICIOUS CYCLE OF REINFORCING FOREIGN EXCHANGE SHORTAGES MUST BE BROKEN. MINFIN THEN OUTLINED SUDAN'S PROGRAM TO ALLOCATE SCARCE FOREIGN EXCHANGE RESOURCES AMONG ESSENTIAL IMPORTS, DEVELOPMENT PROJECTS, AND FULFILLMENT OF EXTERNAL OBLIGATIONS. MINFIN NOTED FOREIGN EXCHANGE PRIORITIES FOR INDUSTRIAL PROJECTS AND INFRASTRUCTURE NOTING THAT THEIR EXPORT AND IMPORT SUBSTITUTION AFFECTS MARGINALLY COULD HELP SUDAN'S PROBLEMS.

11. HORMATS NOTED THAT U.S. COULD NOT PLAY A MAJOR ROLE BUT, IN CONTEXT OF IMF PROGRAM, CAN ENCOURAGE AND SUPPORT
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SUDAN'S ECONOMY. THIS LED MINFIN TO DETAILED DISCUSSION OF EXCHANGE RATE ADJUSTMENT ADVOCATED BY IMF. MINFIN SAID THAT SUDAN HAS THREE PRINCIPAL EXPORT PRODUCTS: COTTON, OIL SEEDS AND GUM ARABIC. DEVALUATION WOULD NOT PRODUCE SIGNIFICANT ADDITIONAL EXPORTS OF THESE COMMODITIES. IN THE CASE OF COTTON, MINFIN FELT THAT SUDAN GOVERNMENT ALREADY IS ADOPTING STRONG ADDITIONAL PRODUCTION INCENTIVES. HOWEVER, HE NOTED THAT THERE WAS RELATIVELY NARROW MARKET FOR TYPE OF LONG STAPLE COTTON PRODUCED BY SUDAN AND THAT INCREASES IN PRODUCTION COULD HAVE NEGATIVE PRICE EFFECTS. THE MARKET'S ABSORPTIVE CAPACITY IS LIMITED AND SUDAN'S PRICING MECHANISMS ARE EXTRACTING PRACTICALLY THE BEST PRICES AVAILABLE. CONCERNING OIL SEED PRODUCTION, HE NOTED THAT SUDANESE PRODUCTION DOES NOT HAVE A SIGNIFICANT EFFECT ON WORLD PRICES WHICH ARE PRIMARILY RELATED TO SOY BEAN PRICES. HOWEVER, THEY HAVE SERIOUS RESERVATIONS ABOUT WHETHER INCREASED DOMESTIC PRICES OF OIL SEEDS WOULD SUBSTANTIALLY INCREASE PRODUCTION. BECAUSE MANY OIL SEEDS ARE PRODUCED IN

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C O R R E C T E D C O P Y (TEXT)

TRADITIONAL AGRICULTURE SECTOR, HE DOUBTED THAT SUPPLY WAS REALLY FLEXIBLE. FURTHER, GIVEN SUDAN'S TRANSPORTATION INFRASTRUCTURE AND REMOTENESS OF OIL SEED PRODUCING AREAS, QUESTION MUST BE CONSIDERED AS TO WHETHER THEY COULD REACH THE MARKET. RE GUM ARABIC, MINFIN CONTENDED THAT SUDAN ALREADY IN IDEAL POSITION AS "MONOPOLY SUPPLIER." DURING RECENT YEARS, THEY HAD EXPERIMENTED WITH PRICES AND NOW BELIEVE THAT THEIR CURRENT STRATEGY PROVIDES MAXIMUM FOREIGN EXCHANGE RETURNS.

12. MINFIN THEN RESPONDED TO QUESTION OF THE SUDAN'S LOSING 30-40 MILLION DOLLARS FROM IMF TRUST FUND. MINFIN CONTENDED THAT IMF POSITION HAD BEEN "UNREASONABLE." TRUST FUND DRAWING COULD HAVE BEEN JUSTIFIED ON OTHER CRITERIA THAN ADOPTION OF ENTIRE IMF PACKAGE INCLUDING EXCHANGE RATE ADJUSTMENTS. IMF HAS INSISTED THAT TRUST FUND BE LINKED TO STANDBY. MINFIN CONTENDED THAT SUDAN'S CURRENT BUDGET STRINGENCIES ALONE WERE RESPONSIVE TO IMF
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AND THEY SHOULD BE SUFFICIENT TO PROVIDE SUDAN ACCESS. THESE CURRENT BUDGET CONTROLS ARE PART OF JANUARY IMF PROGRAM AND SUDAN HAS MAINTAINED THESE CEILINGS AND REFUSED EXTRA-BUDGETARY ALLOCATIONS. HE DESCRIBED SITUATION AS "VERY SAD." CURRENT REFORM EFFORTS ARE BEING HANDICAPPED BY LACK OF ACCESS OF TRUST FUND. IMF POSTURE IS PUNISHING SUDAN FOR ITS REFORMS WHEREAS IMF SHOULD BE ENCOURAGING AND APPLAUDING MEASURES BEING TAKEN BY GOS.

IMF'S ROL IS "NOT TO PUNISH." IMF SHOUD RECOGNIZE THAT FISCAL MEASURES NOW BEING ADOPTED BY SUDAN ARE MUCH MORE IMPORTANT THAN EXCHANGE RATE. "IMF ALWAYS IS AIMING AT TRAGET WHILE SITTING ON HUGE RESOURCES THAT DON'T HATCH." IT IS ADOPTING AN "ALL OR NONE POLICY." MINFIN WITH SOME FEELING SAID THAT SUDANESE WILL NOT JEOPARDIZE THEMSELVES BY PURSUING "BAD AND IRRESPONSIBLE POLICIES." IMF AND OTHER DONORS SHOULD RECOGNIZE THAT SUDAN HAS A MAJOR ROLE, BOTH IN AFRICA AND MIDDLE EAST, AND THAT CARRYING OUT THIS ROLE WILL DEPEND UPON DOMESTIC ECONOMIC DEVELOPMENTS. WITH PROPER SUPPORT, SUDAN IS CAPABLE OF SHOULDERING BROAD REGIONAL RESPONSIBILITIES.

13. HORMATS SUGGESTED THAT SUDAN SHOULD CONSIDER PRESENTING THE MEASURES IT HAS ADOPTED AS "A PACKAGE TO IMF" VERY SOON IN ORDER TO GAIN ACCESS TO TRUST FUND RESOURCES. HARROP NOTED THAT TIME IS SHORT; IMF MUST HAVE ALL DATA READY BY FIRST WEEK JUNE TO ASSESS AS WELL AS APPROVE ACCESS TO TRUST FUND.

14. FINMIN REPLIED THAT THEY WERE WELL AWARE OF SHORT DEADLINE FOR TRUST FUND.; #923;34, THEY HAD ALREADY MADE CASE TO IMF, AND SUDAN GOVERNMENT'S TIME WAS NOW FULLY OCCUPIED WITH PREPARATION OF BUDGET WHICH MUST BE PRESENTED TO PEOPLE'S ASSEMBLY BY JUNE 1. HORMATS SUGGESTED CONFIDENTIAL

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THAT IMF BE GIVEN LOOK AT THIS IN ADVANCE SO THAT I CAN GIVE SUGGESTIONS AS TO HOW IT MIGHT BE IMPROVED OR MODIFIED TO MEET FUND CONDITIONS IN ORDER TO AVOID ASSEMBLY'S PASSING THIS IN EXPECTATION OF FUND SUPPORT AND THEN BEING DISAPPOINTED. MINFIN ACCEPTED THIS POINT AND INDICATED HE HAD BEEN GIVING THHOUGHT TO SAME IDEA. AT THIS POINT, MINFIN GAVE ANOTHER EXAMPLE OF THEIR DIFFI- CULTIES IN NEGOTIATING WITH IMF. SUDAN HAD ACCEPTED IMF SUGGESTIONS ABOUT CHANGING PRODUCTION RELATIONSHIP FOR COTTON. FOR HUGE GAZIRA SCHEME, THIS MEANS SHIFTING REVENUE BASE FROM SHARE OF OUTPUT OF COTTON TO LAND AND WATER USAGE CHARGES APPLIED TO ALL CROPS. THIS PROPOSAL HAS BEEN ACCEPTED BY SUDAN'S COUNCIL OF MINISTERS. HOW- EVER, MINISTERIAL COMMITTEE COMPOSED OF MINISTER OF AGRICULTURE AND MINISTR OF IRRIGATION HAD BEEN ESTABLISHED TO DETERMINE EXACT RATES FOR WATER CHARGES. IMF INTER- FERENCE HAD REACHED POINT THAT THEY INSITED ON REVIEWING IN DETAIL BASIS THESE CHARGES. MINFIN QUESTIONED HOW OFFICIALS IN IMF, BASED IN WASHINGTON, WERE IN POSITION TO TAKE THIS "MOST UNREASONABLE STAND."

15. BOTH HORMATS AND HARROP THANKED MINFIN FOR BEING SO GENEROUS WITH HIS TIME. THIS MEETING HAD SUBSTANTIALLY

CONTRIBUTED TO THEIR UNDERSTANDING OF SUDAN'S ECONOMY.

16. COMMENT: DEVALUTAION IS CLEARLY THE KEY ISSUE. THE TECHNICAL ARGUMENTS ARE COMPLEX AND SUDANESE FEEL A STRONG POLITICAL INHIBITION. A MAIN PROBLEM IS THAT THEY DO NOT KNOW EXTENT OF INTERNATIONAL BALANCE OF PAYMENTS RELIEF THEY WILL RECEIVE IF THEY MEET IMF CONDITIONS. THEY FEEL THEY HAVE NOW IMPLEMENTED SIGNIFICANT REFORMS. TIME IS RUNNINS SHORT AS ECONOMY CONTINUES TO DETERIORATE. MOST USEFUL NEXT STEP FOR U.S. MAY BE TO INITIATE DISCUSSION WITH MAJOR ARAB DONORS TO SEE IF THEY WOULD BE WILLING TO INFORM SUDANESE OF AMOUNTS OF BALANCE OF PAYMENTS SUPPORT THEY COULD MAKE AVAILABLE ONCE AGREEMENT REACHED WITH IMF. CONFIDENTIAL

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U.S. IS PROBABLY NOT IN POSITION TO COORDINATE THIS EFFORT DUE TO LIMITED CONTRIBUTION WE CAN MAKE, AND SAUDIS ARE UNLIKELY TO DO SO. COULD WE CONSIDER ASKING FRG TO TAKE THE LEAD IN THIS SITUATION OF POLITICAL IMPORTANCE TO WESTERN INTERESTS? SOME ACTION MUST BE TAKEN URGENTLY. LEMELLE

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